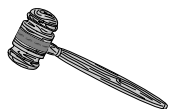


Kentucky Tax Alert



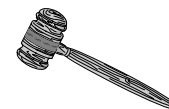
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A Review of Tax Law Changes Enacted by the 2001 General Assembly

(This legislative summary was compiled by the staff of KRC's Division of Tax Policy)



NOTE: This summary of legislation enacted by the 2001 General Assembly is intended to present only general information concerning the major provisions of the legislation and should not be construed to represent a complete analysis or specific interpretations of the law changes. Information that is more specific will be provided to taxpayers as the legislative changes are implemented. Full text of enacted bills is available on the legislative home page <http://www.lrc.state.ky.us>.

The 2001 Kentucky General Assembly created, amended, or repealed numerous statutes during the recently completed regular session. A total of 579 bills and 333 resolutions were introduced. Of this total, 128 bills became law for an enactment rate of just above 22 percent.

Twelve bills and resolutions had substantive tax implications. The tax portion of each bill is described in this review. Effective dates are shown when specifically stated in the legislation. Otherwise, the changes are effective June 21, 2001.

PROPERTY TAX

Tax Increment Finance (TIF) Zones—New sections of KRS Chapter 65 were created to allow the development of TIF zones, based on contracts executed between a development agency and the city, county, and/or state (school districts may not participate). When a TIF zone is delineated, a base year is established, and any new tax revenue generated in excess of the base year revenue is dedicated to funding development within the TIF zone. "New revenues" are defined as "any tax revenues received by any taxing district or the state." For example, this may include property tax, sales tax, income taxes, and local occupational taxes. **(HB 238)**

Nonferrous Metals Futures Commodities—(Effective Jan. 1, 2001) KRS 132.200 was amended to create a new classification of tangible personal property. This bill exempts nonferrous metals futures commodities held on warrant in a commodity warehouse from local taxation. In order to qualify, these metals have to conform to the quality, shape, and weight specifications set by the New York Mercantile Exchange's special contract rules for metals, and must be located or stored in a commodity warehouse as defined by statute. Now listed in the "state rate only" statute, KRS 132.200, these commodities would be subject to a 5 cent per \$100 state rate only, as inventory. **(HB 284)**

SALES AND USE TAX

"Plant Facility" Defined—(Effective March 15, 2001, the provisions of this legislation apply retroactively to Sept. 28, 2000.) KRS 139.170 was amended to provide a definition of "plant facility" as it applies to the machinery for new and expanded industry exemption. The effect of this legislation is to preserve the long-standing administrative construction of this sales and use tax exemption to machinery that is for incorporation at an industrial plant site. To meet the definition of "plant facility" a location must be exclusively dedicated to manufacturing or processing production activities. Restaurants, grocery stores, shopping centers, or other retail establishments are specifically excluded from the definition of a "plant facility." However, incidental retail activity at the plant site will not disqualify the facility from the exemption. This language effectively restores the exemption to its historical meaning prior to the Supreme Court decision rendered in *Camera Center, Inc. v. Revenue Cabinet*, Ky., 34 S.W.3d 39 (2000).

This bill also incorporates into statutory language the meanings of the terms "manufacturing" and "manufacturing process" that have been shaped by Kentucky courts and historically used by the Cabinet to administer this exemption.

A final provision of the bill requires that any claim for a refund made after Sept. 28, 2000, for tax paid on machinery incorporated into a plant facility must conform to the meaning of "plant facility" as defined in this legislation. **(HB 201)**

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Uniform Sales and Use Tax Administration Act—A new section of KRS 139 was created to enable Kentucky to continue its leadership role in the Streamlined Sales Tax Project. The Streamlined Sales Tax Project is a 39-state effort to simplify and modernize the administration of the sales and use tax for all forms of commerce including catalog and Internet sales. The completion of this project should ensure the fair collection of taxes from remote and local sellers alike. The passage of this bill does not change existing state tax laws. **(HB 367)**

Free Drug Samples—(Effective July 1, 2001) KRS 139.472 was amended to allow for the exemption of free drug samples that are distributed to or from a physician's office. These samples must be of a type that are commonly recognized as substances or preparations prescribed and dispensed for use by external or internal application to the human body in the diagnosis, cure, mitigation, treatment, or prevention of disease. **(HB 370)**



INCOME TAX

Secondary Wood Products Industry Granted Priority Consideration for Economic Development Programs—KRS 154.20-170 was amended to add the secondary wood products industry as defined in KRS 154.47-005(10) to the list of business entities that are given priority consideration for various economic development loan, grant, and incentive programs. **(SB 47)**

Local Governing Bodies Establishing a Development Area May Impose a Job Development Assessment Fee—(Effective for projects begun after Jan. 1, 2002) New sections of KRS 65.680 to 65.699 were created to provide that any governing body establishing a development area may impose a job development assessment fee (JDAF) on each person whose job was newly created at a project in the development area and who is subject to individual income tax under KRS 141.020. The total JDAF imposed by all governing bodies within the development area shall not exceed 3 percent of the employee's gross wages. Each person subject to the JDAF shall be entitled to a credit against Kentucky income tax withheld equal to the amount of JDAF imposed. The amount of JDAF for each company shall be subject to approval by the Office of the State Budget Director, the Finance and Administration Cabinet, and the Revenue Cabinet. Approval shall not be granted if it is determined that the project does not result in a net positive economic impact to the commonwealth. **(SB 47)**

Kentucky Industrial Revitalization Act (KIRA) Tax Credits—(Effective March 20, 2001) KRS 154.26-010 and 154.26-080 were amended to add to the list of companies eligible for KIRA incentives, companies engaged in coal mining and processing operations in the state which employ 500 people and produce at least four million tons of coal annually. The approved company must mine or process coal that is subject to the Kentucky coal severance tax imposed by KRS Chapter 143. **(HB 325)**

Tobacco Loss Assistance Program (TLAP)—KRS 141.010(10)(q) and KRS 141.010(12)(k) were amended to exclude from income any amount received for TLAP



payments resulting from a reduction in the quantity of federal tobacco quota allotted. The exclusion applies retroactively to taxable years beginning after Dec. 31, 1999. **(HB 209)**

MISCELLANEOUS TAXES

Gray Market Cigarettes—(Effective Jan. 1, 2002) A new section of KRS Chapter 248 was created to make the possession, sale, or distribution of gray market cigarettes illegal under state law. **(HB 279)**



Marijuana Tax—KRS 138.870, 138.880, and 138.882 were amended to provide that the tax on marijuana and controlled substances shall not be assessed until the dealer's taxable activity results in a criminal conviction or a guilty or Alford plea from an offender for violating KRS Chapter 218A. The bill allows the Revenue Cabinet to file a notice of lien on issuance of a warrant or indictment. **(HB 356)**

RESOLUTIONS

Weight Distance and Usage Tax Study—This resolution directs the Interim Joint Committee on Appropriations and Revenue to conduct a study of the weight distance tax and the usage tax on motor carriers and options for replacing lost revenue if the taxes are eliminated or modified. The committee is also directed to study the development of passenger and freight rail initiatives in the commonwealth. The resolution provides that the study shall not be conducted if the General Assembly enacts a resolution to study tax reform that would encompass these areas of interest, including the weight distance tax. Accordingly, this study may become part of the overall tax reform study directed by HJR 30. **(HCR 8)**

Tax Policy Issues Subcommittee of the Appropriations and Revenue Committee—The Tax Policy Issues Subcommittee will consist of eight members each from the Senate and House Committees on Appropriations and Revenue, including the respective chairs who will serve as co-chairs. Executive Branch participation was limited to a request for the governor to make recommendations and designate executive branch employees to present data, research, and testimony to the subcommittee.

The Tax Policy Issues Subcommittee is required to hold its first meeting no later than May 1, 2001, and report its findings to the Interim Joint Committee on Appropriations and Revenue prior to the start of the 2002 Regular Session. The subcommittee shall cease to exist April 15, 2002. **(HJR 30)**

Holiday Office Closures

Pursuant to KRS 18A.190, all KRC offices will be closed on Monday, May 28, 2001, in observance of Memorial Day; and Wednesday, July 4, 2001, in observance of Independence Day.



Modern Filing Methods Continue to Gain in Popularity

KRC's alternatives to the traditional paper method of filing individual income tax returns continue to gain in popularity among taxpayers.

Both electronic filing and telephone filing of 2000 returns enjoyed significant increases over the previous year. Online filing, offered for the second time in the 2000 tax year, drew a significant number of participants.

KRC received 400,972 electronically filed 2000 tax returns, as compared with more than 331,000 1999 returns, an increase of 21 percent.

In its third year of offering TeleFile, KRC accepted 47,502 returns filed by phone. The previous year, more than 54,000 returns were filed. This 13 percent decrease is a result of Telefile taxpayers changing to other electronic methods of filing, such as electronic filing or online filing.

In 2001, for the second year, KRC offered online filing of tax returns via partnerships with software developers. A total of

45,578 taxpayers took advantage of this service and filed their 2000 tax returns via the Internet. When compared to nearly 30,000 who filed their return in this manner last year, this represents an increase of 56 percent.



All told, KRC received more than 494,052 returns filed via nontraditional means. Filing electronically, via phone, or online allows taxpayers to receive refunds faster and eliminates manual processing of paper returns.

KRC will continue to accept 2000 individual income tax returns filed electronically and via the Internet through Oct. 15, 2001. Those wishing to use telephone filing, TeleFile, will have until Aug. 15, 2001, to file returns.

KRC thanks those who participated in its various modernized filing programs and looks forward to the continued success and growth of these programs.

Publications Now Available on KRC's Web Site

Several publications are now available on KRC's Online Taxpayer Service Center (TSC). These include recent editions of KRC's annual report; **Tax Facts**, a digest of Kentucky tax laws; property tax rates for 2000; and withholding tax guidelines.



KRC Annual Report

The **1999-2000 KRC Annual Report** contains highlights of KRC programs during the previous fiscal year, including an overview of the Cabinet's **EMPOWER Kentucky** programs, a review of tax law changes enacted by the 2000 General Assembly, and a 10-year performance history for the General and Road funds by tax type.

Tax Facts

The 2000 edition of the **Tax Facts—A Digest of Kentucky Tax Laws** booklet contains answers to the most frequently asked questions about taxation in the Bluegrass State. It's a valuable resource for tax professionals or anyone who needs information about Kentucky taxes.

Property Tax Rates 2000

Property Tax Rates 2000, a publication by the Department of Property Valuation, lists ad valorem property tax rates levied by state and local governmental units in Kentucky, including county, city, school, and special district levies. This is the 52nd annual publication of this rate schedule.

Withholding Tax Instructions

The new version of **Withholding Kentucky Income Tax—Instructions for Employers and Withholding Tax Tables** is available online. Revised in September 2000, this 60-page booklet contains:

- withholding tables;
- instructions on withholding Kentucky individual income tax;
- optional computer formula withholding method; and

- reproducible forms and nonreproducible completed samples of other forms.

The **Withholding Kentucky Income Tax—Instructions for Employers and Withholding Tax Tables** booklet is a 7.9 MB PDF file. Adobe Acrobat Reader software is required to view and/or print this publication.

For those who do not wish to download the entire booklet, the withholding tables for the 2001 tax year and reproducible withholding and tax registration forms are available individually.

For more information about this publication, contact the Withholding Tax Section at (502) 564-7287.

KRC's Online TSC is accessible at <http://revenue.state.ky.us>. If you have comments on the Web site or suggestions for additions, you may e-mail them to KRC's Webmaster at revweb@mail.state.ky.us.



Corporate Annual Reports Due in Secretary of State's Office

Annual reports for all corporations and limited liability companies are due in the office of the Secretary of State on June 30, 2001. The office of the Secretary of State may send the organization a reminder notice if the annual report is not filed. Failure to timely file the annual report may result in administrative dissolution of a domestic corporation or limited liability company; or revocation of the certificate of authority of a foreign corporation or a foreign limited liability company.

Direct questions concerning the filing of these annual reports to the Secretary of State's office at (502) 564-3490.

Court Case Update

Sales and Use Tax—On March 22, 2001, in **Revenue Cabinet v. Hubbard d/b/a Stone Age Dental Laboratory**, 1999-SC-0171-DG and 1999-SC-0992-DG, the Kentucky Supreme Court denied the taxpayers' petition for rehearing. Therefore, this case is now final.

The Supreme Court had previously rendered its decision in **Revenue Cabinet v. Hubbard d/b/a Stone Age Dental Laboratory** on Dec. 21, 2000. This case concerned the application of the exemption contained in KRS 139.472 for prosthetic devices to a dentist's purchases of dentures, crowns, bridges, etc. Specifically, the issue before the Supreme Court was whether the dental items were "prosthetic devices . . . individually designed, constructed or altered solely for the use of a particular crippled person so as to become a brace, support, supplement, correction or substitute for the bodily structure . . ."

The court began its analysis with the principle that tax exemption statutes such as KRS 139.472 are narrowly construed. In this case, the court stated that it viewed the resolution of the issue before it as turning on the meaning of the word "crippled." The meaning of "crippled" in KRS 139.472, the court held, embraced the definition that someone is considered "crippled" when he or she is deprived of the use of a limb. The court further stated, "Clearly, this exemption is limited to persons who have difficulty walking or are unable to walk."

The court further reasoned that "[w]hile we are unable to find a definition for the term 'bodily structure,' the use of the definite article 'the' indicates that the statute refers to the entire body and not to discrete parts or components that could be considered a 'bodily structure,' e.g., the mouth." The Supreme Court concluded that "[i]n other words, a person who needs dentures, crowns, bridges or braces for his or her teeth is not 'crippled' within the meaning of the statute."



Revenue Cabinet Secretary Mike Haydon, Commissioner Dana Mayton, and Director Charlotte Quarles joined Governor Paul Patton, Lieutenant Governor Steve Henry, and legislators for a bill-signing ceremony in the Capitol Rotunda on March 22, 2001. During the event, Governor Patton signed two revenue-related bills passed during the historic 2001 Regular Session of the Kentucky General Assembly.

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<http://revenue.state.ky.us>

To provide courteous, accurate and efficient services for the benefit of Kentucky and its citizens, and administer the tax laws of the Commonwealth in a fair and impartial manner.

Kentucky Revenue Cabinet
Mission Statement

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